This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 MANILA 001840

SIPDIS

SENSITIVE

STATE FOR EAP/PMBS, EAP/EP, EB/IFD
STATE ALSO PASS EXIM, OPIC, AND USTR
STATE ALSO PASS USAID FOR AA/ANE, AA/EGAT, DAA/ANE
TREASURY FOR OASIA
USDOC FOR 4430 ITA/MAC/ASIA & PAC/KOREA & SE ASIA/ASEAN

E.O. 12958: N/A
TAGS: EFIN ECON EINV PGOV RP
SUBJECT: Senate Passes Value Added Tax Bill

REF: Manila 0646

Sensitive but Unclassified. Please protect accordingly.

¶1. (U) Summary: The Philippine Senate approved on April 13 proposed amendments to the value-added tax law. Bicameral conference committee hearings are deliberating over the House and Senate proposals, with a reconciled bill targeted for signing by President Macapagal-Arroyo on April 30. The executive branch is pushing for a simple bill to increase the current unitary 10% VAT rate to 12% and limit exemptions. The bills that emerged from both chambers, however, attempt to satisfy a cacophony of conflicting interests and contain provisions opposed by the business sector, such as preventing power sector firms from passing on VAT to their customers, increasing the already high corporate income tax rate, and staggering rebates for capital equipment over five years. The Embassy continues to work with the American Chamber and U.S. companies in affected sectors and explain to key members of Congress the need for a fair and credible VAT law. End Summary.

¶2. (U) On April 13, 2005 the Philippine Senate passed its version of proposed amendments to the Philippines' value added tax (VAT) law to raise revenues for the cash-strapped Government. The House of Representatives had earlier approved proposed amendments to the VAT law in two separate bills (reftel) that would generally increase the current VAT rate from 10% to 12%, except for reduced rates on petroleum, power, and other "socially sensitive" products, and narrow the list of VAT-exempt transactions.

Senate Sticks to 10% VAT; Tinkers with Other Taxes

¶3. (U) Senate Bill (SB) 1950 maintains the VAT at a uniform rate of 10%, but compensates by raising government revenue in the following ways:

-- Lifting exemptions on a wider range of transactions than approved by the House, including withdrawing VAT exemptions on certain nonfood agricultural products, on the sale or importation of coal and natural gas, on the importation and sale by electric cooperatives, on direct sales by an artist of his works of art, on operators of cabarets and night and day clubs, and on loans extended by credit and multi-purpose cooperatives to non-members;

-- Subjecting services rendered by domestic air and water carriers to VAT (in exchange for scrapping the 3% franchise tax currently in place);

-- Temporarily increasing the Philippines' already high corporate income tax rate from 32% to 35% until end-2008;

-- Increasing the gross receipts tax from 5% to 7% on certain revenues of the banking sector and non-bank financial intermediaries, such as royalties, property rentals, and net gains on foreign currency debts, derivatives and similar instruments.

Casting the VAT Net Over the Fuel and Power Sectors

¶4. (U) The Senate voted to cast the VAT net over the currently VAT-exempt importation and sale of petroleum products. SB 1950 would also impose VAT on the sales of power generation companies (including Independent Power Producers - IPPs) from non-renewable sources of energy, which are currently zero-rated, and tax sales of power transmission and distribution firms, which are currently VAT-exempt. (Note: For zero-rated transactions, no output VAT is paid and VAT paid on inputs may be refunded or credited against other taxes. VAT-exempt transactions are not entitled to input tax credits. End Note.)

¶5. (U) Reflecting intentions to temper the impact on electricity rates, SB 1950 would repeal the 2% franchise tax currently imposed on electric utilities and scrap excise taxes on diesel (from 1.63 pesos/liter), bunker fuel (from 30 centavos/liter), and kerosene (from 60 centavos/liter). The Senate bill also contains a "no pass-through" provision that would prevent power generation, transmission and distribution companies from passing on the VAT to residential customers.

¶6. (U) Proposed legislation earlier passed by the House of Representatives would lift the VAT-exempt status of fuel products and zero-rated status of power generated through non-renewable energy sources without touching excise and franchise taxes. However, the House proposal would apply the 12% VAT rate on a staggered basis (i.e., 4% on the first year, rising to 6%, 8% and 12% during the second, third, and fourth years, respectively). Power generated from wind, biomass, and solar energy would be VAT-exempt (instead of zero-rated) and the rest subject to VAT. The House bill prevents IPPs from passing on the VAT to any customers, and includes a "no pass-through" provision for purchases of petroleum products as well.

--- --
Battle Shifts to Bicameral Conference Committee
--- --

¶7. (U) A bicameral conference committee began deliberations on April 15 to reconcile the Senate and House versions of the proposed VAT amendments. Speaker Jose De Venecia and Senator Franklin Drilon publicly expressed confidence that a reconciled bill will be ready for President Gloria Macapagal-Arroyo's signature by April 30.

¶8. (U) Meanwhile, tax experts fear that the end result will be a convoluted bill that, by seeking to satisfy many conflicting interests, could eventually prove difficult to administer. In addition to being more complicated administratively by departing from a unitary VAT rate, the Lower House's proposal to tax locally manufactured "socially sensitive" products - i.e., mackerel/sardines, milk, refined sugar, cooking oil, instant packed noodles, and generic medicines - at a lower 6% VAT versus the 8% rate proposed for imported counterparts is inconsistent with WTO commitments. Econoffs have shared this observation with GRP officials and legislators.

¶9. (U) Foreign and local business chambers here also continue to express grave concern over provisions in either or both Senate and House bills that would unduly penalize the business sector and cloud the investment climate -- particularly the proposed "no pass-through" provisions for petroleum and power (septel), corporate income-tax hike, and staggered crediting over a five-year period of input VAT for purchases of capital equipment.

¶10. (SBU) Finance Secretary Purisima told econoffs that the GRP wants a simple increase in the VAT to a unitary 12% rate and fewer exemptions to raise 62-89 billion pesos ($1.1-1.6 billion) in annual incremental revenues. While the DOF estimates that the House and Senate versions could raise revenues very close to the DOF's original proposal (i.e., about 60-85 billion), GRP officials share concerns over the more convoluted bills that have emerged thus far and the potentially adverse impact of some provisions on the business climate and investor perception. Although at a press conference April 14, President Arroyo said she was letting the legislators work out how to achieve her revenue goal, more recent pronouncements by her staff state a clear preference for a full 2% increase in the VAT rate, perhaps allowing fewer provisions that might deter investors and businesses.

Comment

¶11. (SBU) The passage of a VAT bill that generates significant additional revenue without severe adverse effect on the investment and business climate is critical to improving the country's fiscal position, government credibility and macroeconomic stability. With only two revenue-enhancing bills passed to-date (i.e., higher excise taxes for liquor and tobacco and a lateral attrition program for revenue collection agencies), the GRP is depending heavily on VAT legislation to deliver the bulk of its 80-billion peso goal from new revenue laws. Public resistance to new and/or higher taxes has intensified so the VAT bill could be the "last hurrah" for enacting new tax measures. Together with the American Chamber of Commerce and U.S. power generation firms operating here, the Embassy continues to encourage

VAT legislation that is credible, fair, WTO-consistent, and will foster fiscal viability and growth as well as the confidence of businesses and investors.

Ricciardone